



## **SMALL BUSINESS ADMINISTRATION**

**[Docket No. SBA-2022-0003]**

### **13 CFR Parts 120 and 121**

#### **Community Advantage Pilot Program**

**AGENCY:** Small Business Administration.

**ACTION:** Notification of changes to Community Advantage Pilot Program, impact on regulations, and request for comments.

**SUMMARY:** The Small Business Administration (SBA) continues to refine and improve the design of the Community Advantage (CA) Pilot Program. SBA is issuing this document to revise the CA Pilot Program requirements to encourage increased lending in historically underserved markets.

**DATES:** The changes identified in this document take effect [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

*Comment date:* Comments must be received on or before [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** You may submit comments, identified by SBA docket number SBA-2022-0003, by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

- Mail: Darrel Eddingfield, Office of Financial Assistance, U.S. Small Business Administration, 409 Third Street SW, Washington, DC 20416.

SBA will post all comments on <https://www.regulations.gov>.

If you wish to submit confidential business information (CBI) as defined in the User Notice at <https://www.regulations.gov>, please submit the information to Darrel Eddingfield, Office of Financial Assistance, U.S. Small Business Administration,

409 Third Street, SW, Washington, DC 20416, or send an email to [communityadvantage@sba.gov](mailto:communityadvantage@sba.gov). Highlight the information that you consider to be CBI and explain why you believe SBA should hold this information as confidential. SBA will review the information and make the final determination as to whether it will publish the information.

**FOR FURTHER INFORMATION CONTACT:** Darrel Eddingfield, Office of Financial Assistance, U.S. Small Business Administration, 409 Third Street SW, Washington, DC 20416; telephone: (202) 516-6676; email: [darrel.eddingfield@sba.gov](mailto:darrel.eddingfield@sba.gov).

**SUPPLEMENTARY INFORMATION:**

**1. Background**

SBA has the authority to suspend, modify, or waive certain regulations in establishing and testing pilot loan initiatives under 13 CFR 120.3. On February 18, 2011, SBA issued a notice and request for comments introducing the CA Pilot Program (76 FR 9626), which was created to meet the credit needs of small businesses in underserved markets. In that notice, SBA modified or waived as appropriate certain regulations which otherwise apply to 7(a) loans for the CA Pilot Program.

Subsequent notices revised the CA Pilot Program to improve the program experience for participants, improve CA Lenders' ability to deliver capital to underserved markets, and appropriately manage risk to the Agency. These notices were issued on the following dates: September 12, 2011 (76 FR 56262), February 8, 2012 (77 FR 6619), November 9, 2012 (77 FR 67433), December 28, 2015 (80 FR 80872), September 12, 2018 (83 FR 46237), March 2, 2020 (85 FR 12369), and July 15, 2020 (85 FR 42964). On April 1, 2022 (87 FR 19165), SBA issued a notice extending the CA Pilot Program until September 30, 2024 and lifting the moratorium previously imposed on SBA accepting new CA Lender applications.

**2. Comments**

Although the changes take effect [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER], comments are solicited from interested members of the public on all aspects of the CA Pilot Program. Comments must be submitted on or before the deadline for comments listed in the DATES section. SBA will consider these comments and the need for making any future revisions to the CA Pilot Program.

### 3. Changes to the CA Pilot Program

Under 13 CFR 120.3, SBA has the authority to test new programs or ideas in pilot programs that are limited in size and duration to protect SBA from undue risk of loss. Testing new ideas in a limited pilot program provides SBA with an opportunity to collect data to determine which ideas most effectively accomplish the intended goals and can be introduced as permanent rule changes versus other ideas that can be quickly terminated when data indicates they produce poor results. SBA has determined there is a gap in funding to underserved markets and in small dollar loans. Because the CA Pilot Program is specifically focused on making small loans in underserved markets, SBA is using its authority under 13 CFR 120.3 to implement the following modifications to determine their effectiveness in expanding capital to underserved markets and increasing small dollar loans.

#### a. Modification of 13 CFR 120.410 and 120.440 for Participation in and Use of Delegated Authority in the CA Pilot Program

To close the gap in funding for small businesses in underserved markets by expediting loan decisions for small dollar loans, SBA is modifying the regulations at 13 CFR 120.410 and 120.440, using the term modify as contemplated under 13 CFR 120.3, for lender participation in the CA Pilot Program and the conditions under which SBA will grant delegated authority to CA Lenders to make CA loans without prior SBA review of eligibility or creditworthiness. Subject to SBA's review and prior approval, SBA may

authorize certain CA Lenders to make CA revolving lines of credit. Until receiving written authorization from SBA, CA Lenders will not be permitted to approve revolving lines of credit, under either delegated or non-delegated authority.

**New lenders:** A lender that is not an existing CA Lender as of April 1, 2022, must be approved by SBA to participate in the CA Pilot Program before it can begin making CA loans. A new lender applying to participate as a CA Lender must demonstrate at the time of its application that it currently has at least 20 similarly-sized commercial or business loans in its portfolio. This level of experience is necessary because SBA will be granting delegated authority if the Lender is approved to participate in the pilot.

**Existing CA Lenders that have delegated authority:** These CA Lenders do not have to take any action and may begin using the procedures in the updated CA Participant Guide when it is published.

**Existing CA Lenders that do not have delegated authority as of April 1, 2022:** Notwithstanding the new authorities stated above, these CA Lenders must continue to submit loan applications through the Loan Guaranty Processing Center (LGPC) using nondelegated authority until that time as they qualify for and are approved for delegated authority. For these CA Lenders, SBA will grant delegated authority under the rules that were in effect at the time the CA Lender was approved to participate in the CA Pilot Program. Alternatively, a CA Lender may apply for delegated authority at any time if it can demonstrate that it currently has at least 20 similarly-sized commercial or business loans in its portfolio, which may include its CA loans.

b. Modification of 13 CFR 120.150 Relating to Lending Criteria

SBA is modifying the regulation at 13 CFR 120.150, using the term modify as contemplated under 13 CFR 120.3, which describes the lending criteria that SBA and participating lenders must consider when underwriting SBA-guaranteed loans. CA Lenders must ensure the Applicant (including an Operating Company) is creditworthy

and loans are so sound as to reasonably assure repayment. CA Lenders must use appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans. When approving CA loans, CA Lenders may consider any of the following criteria: credit score or credit history of the Applicant (and the Operating Company, if applicable), its Associates and any guarantors; the earnings or cashflow of Applicant; or where applicable any equity or collateral of the Applicant.

Additionally, CA Lenders may use a business credit scoring model. CA Lenders may use the FICO® Small Business Scoring Service<sup>SM</sup> Score (SBSS) credit scoring model used in SBA's 7(a) Small Loan Program or other credit scoring models. If a CA Lender uses a credit scoring model other than SBSS, the CA Lender must validate the model, document with appropriate statistical methodologies that their credit analysis procedures are predictive of loan performance and must provide that documentation to SBA upon request and during lender oversight reviews. Credit scoring models could incorporate, for example, the earnings and cashflow of an Applicant, equity, or collateral, in which case those factors would not necessarily be separately considered by a CA Lender unless otherwise specified by SBA Loan Program Requirements as defined in 13 CFR 120.10 (e.g., where SBA requires an equity injection for certain project financing). SBA will continue to require new CA Lender Applicants to submit their credit policies at the time of application.

The use of credit scoring models will not replace the requirement for CA Lenders to comply with other SBA Loan Program Requirements, for example, ensuring the project meets program eligibility requirements, adequate controls on disbursements are in place, providing accurate descriptions of uses of proceeds, and documenting that credit is not available elsewhere.

c. Modification of 13 CFR 120.110(n) for the Community Advantage Pilot Program

SBA is modifying the regulation at 13 CFR 120.110(n), using the term modify as contemplated under 13 CFR 120.3, to remove restrictions that make ineligible any business with an Associate who is incarcerated, on probation, on parole, or has been indicted for a felony or a crime of moral turpitude. CA Lenders may continue to conduct background checks and make risk-based lending decisions in accordance with their own policies. SBA is making this change to address concerns regarding equitable access under SBA programs and economic opportunities for these individuals. There are roughly as many Americans with criminal records as with college degrees<sup>1</sup>, and the criminal justice system disproportionately entangles Americans of color. Individuals with prior convictions often have difficulty finding jobs, many experience discrimination, others lack technical skillsets for the modern workforce, and all face 29,000 employment-related legal restrictions (e.g., inability to acquire licenses).<sup>2</sup> Entrepreneurship may offer this population a strong alternative, but many formerly incarcerated individuals have little access to the credit necessary to start a business.

d. Modification of 13 CFR 120.151 to Increase Maximum Allowable CA Loan Size From \$250,000 to \$350,000

When SBA introduced the CA Pilot Program, it modified the maximum loan amount for 7(a) loans in 13 CFR 120.151 to establish a maximum CA loan size of \$250,000. In this document, SBA is again modifying 13 CFR 120.151, using the term modify as contemplated under 13 CFR 120.3, to increase the maximum CA loan size to \$350,000 to align with the current definition of a small loan as used in the regular 7(a) program. While still considered small dollar loans, the larger loan amount limit will allow

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<sup>1</sup> Just Facts: As Many Americans Have Criminal Records as College Diplomas. Brennan Center for Justice.

<sup>2</sup> The Price We Pay: Economic Costs of Barriers to Employment for Former Prisoners and People Convicted of Felonies. Center For Economic And Policy Research, June 16, 2016.

Applicants to make necessary investments to start new businesses such as the purchase of commercial real estate, machinery and equipment, and inventory.

e. Modification of 13 CFR 120.221(a) to Revise Maximum Allowable Fees a CA Lender May Charge

Currently, 13 CFR 120.221(a) permits Lenders to charge an Applicant a reasonable fee to assist the Applicant with the preparation of the application and supporting materials. However, SBA does not permit Lenders to charge an Applicant a commitment, broker, referral, or similar fee. SBA SOP 50 10 provides guidance on allowable fees and compensation all Lenders, including CA Lenders, may charge an Applicant. In a notice published on September 12, 2018 (83 FR 46237), SBA modified 13 CFR 120.221(a) to limit the fees that a CA Lender or Agent is permitted to collect from the Applicant to no more than \$2,500.

SBA determined the limits on fees may negatively affect CA Lenders' willingness to make loans under the CA Pilot Program. Therefore, SBA is modifying the allowable fee structure to offset costs that may prevent CA lenders from making more loans, especially small loans under \$50,000. One of the ways SBA 7(a) Lenders are permitted to charge a fee for packaging and other services is based on a percentage of the loan amount, which is 3 percent for loans of \$50,000 and less, and 2 percent for larger loans. This allows a 7(a) Lender to charge a fee of up to \$7,000 for a \$350,000 7(a) loan where the CA Lender is currently permitted to charge a fee of up to \$2,500 for all CA loans.

For these reasons, SBA is again modifying 13 CFR 120.221(a), using the term modify as contemplated under 13 CFR 120.3, and revising the method of calculating the maximum fee a CA Lender may charge the Applicant for packaging and other services as follows:

- i. For CA loans up to \$5,000: Fee may not exceed 10 percent of the loan amount;

- ii. For CA loans greater than \$5,000 and up to and including \$10,000: Fee may not exceed \$500;
- iii. For CA loans greater than \$10,000 up to and including \$50,000: Fee may not exceed 5 percent of the loan amount or \$1,750, whichever is less; and
- iv. For CA loans greater than \$50,000: Fee may not exceed 2.5 percent or \$1,750, whichever is greater.

Except for necessary out-of-pocket costs such as filing or recording fees permitted in § 120.221(c), this is the only fee or compensation a CA Lender may directly or indirectly collect from an Applicant for assistance with obtaining a CA loan. In addition, the CA Lender may not split a loan into two loans for the purpose of charging an additional fee to an Applicant. Any fees the CA Lender or any Agent charges an Applicant must be disclosed to the Applicant and SBA by completion of the SBA Form 159, “Fee Disclosure Form and Compensation Agreement,” and the CA Lender must electronically submit a copy of the executed form and any supporting documentation through SBA’s Capital Access Financial System (CAFS). SBA’s Office of Credit Risk Management (OCRM) tracks fees and compensation Lenders and Agents collect from Applicants and Borrowers to allow SBA to monitor and track the actual costs to Borrowers in obtaining SBA-guaranteed loans.

SBA considers the revised fee structure to be reasonable. SBA will continue to monitor this fee structure and may revise this amount by publishing a notice with request for comment in the *Federal Register*.

f. Modification of 13 CFR 120.213, 120.214, and 120.215 to Revise Maximum Allowable Interest Rates a CA Lender May Charge

When SBA announced the CA Pilot Program and again in a subsequent notice, it modified the regulations at 13 CFR 120.213, 120.214, and 120.215 in order to permit CA Lenders to charge up to Prime plus 6 percent on loans of any size. (See, 79 FR 9626,



February 18, 2011, and 77 FR 6619, February 8, 2012.) To incentivize CA Lenders to make more smaller dollar loans, SBA is again revising the regulations at 13 CFR 120.213, 120.214, and 120.215, using the term modify as contemplated under 13 CFR 120.3, by setting the maximum interest rates that CA Lenders may charge. For CA loans approved on or after the effective date of this document, CA Lenders may charge, for loans up to \$50,000, Prime plus 6.5 percent; for loans greater than \$50,000 up to and including \$250,000, Prime plus 6 percent; for loans greater than \$250,000 up to and including \$350,000, Prime plus 4.5 percent.

g. Revise Collateral Requirements for CA Loans

SBA is making the following changes to collateral requirements to increase the speed with which CA Lenders may make small loans while also decreasing costs to the CA Lender and Borrower. Personal and/or corporate guaranties must still be obtained in accordance with 13 CFR 120.160(a) and SOP 50 10.

**Loans \$50,000 or less:** CA Lenders currently are required to follow the guidance on collateral provided in the CA Participant Guide and in SBA SOP 50 10, which states that for loans of \$25,000 or less, the CA Lender is not required to take collateral. For CA loans approved on or after the effective date of this document, SBA will not require CA Lenders to take collateral on loans of \$50,000 or less.

**Loans greater than \$50,000:** SBA currently requires that for CA loans over \$50,000, the CA Lender must follow the collateral policies and procedures it has established and implemented for its similarly-sized, non-SBA-guaranteed commercial loans; however, at a minimum, the CA Lender must require as collateral a first lien on all assets financed with the CA loan proceeds. The CA Lender is also required to take a lien on all the Borrower's fixed assets, including real estate, up to the point the CA loan is "fully secured" in accordance with the collateral valuations provided in SOP 50 10 6, Part

2, Section B, Chapter 1. Upon the effective date of this document, SBA will require the CA Lender to take real estate as collateral only if one of the following conditions are met:

- i. The real estate is being acquired with the CA loan proceeds; or
- ii. The CA loan proceeds will finance improvements to real estate owned by the Borrower or its Associates; or
- iii. The CA loan proceeds will refinance debt originally used to acquire, or improve the real estate owned by the Borrower or its Associates.

h. Modification of 13 CFR 120.130(c) to Allow Certain CA Lenders to Provide Revolving Lines of Credit

Under the existing CA Pilot Program, CA Lenders are not authorized to make revolving lines of credit. To improve access to working capital in underserved markets, SBA is modifying the regulation at 13 CFR 120.130(c), using the term modify as contemplated under 13 CFR 120.3, which currently prohibits a borrower from using loan proceeds for floor plan financing or other revolving line of credit, except under the Export Working Capital Program or the CAPLines Program. Subject to SBA's review and prior approval, SBA may authorize certain CA Lenders to make CA revolving lines of credit. Until receiving written authorization from SBA, CA Lenders will not be permitted to approve revolving lines of credit, under either delegated or non-delegated authority.

i. Modification of 13 CFR 120.160(c) to Revise the Requirement for Hazard Insurance for CA Loans

As set forth in 13 CFR 120.160(c), SBA currently requires hazard insurance on all collateral and does not distinguish this requirement by loan size. SBA determined that the hazard insurance requirement is particularly burdensome and costly for businesses seeking small dollar loans. Therefore, SBA is modifying the regulation at 13 CFR 120.160(c), using the term modify as contemplated under 13 CFR 120.3, to permit CA

Lenders to follow the hazard insurance policies and procedures they have established and implemented for their similarly-sized, non-SBA-guaranteed commercial loans.

CA Lenders must continue ensuring that Borrowers obtain flood insurance per 13 CFR 120.170 when required under the Flood Disaster Protection Act of 1973 (42 U.S.C. 4000 *et seq.*).

j. Modification of 13 CFR 121.301(f) to Modify the Affiliation Principles for Applicants for CA Loans

Currently, 13 CFR 121.301 states the size standards and affiliation principles that are applicable to SBA's financial assistance programs. Paragraph (f) details how affiliation principles are applied for the 7(a) Loan Program, among others. This paragraph has seven sub-paragraphs, each of which details a separate affiliation principle that must be applied to the applicant and other entities to determine whether the entities are affiliated. The determination of affiliation is necessary to ensure that an applicant is "small" for purposes of eligibility for SBA financial assistance and to ensure that the applicant (including affiliates) does not exceed the maximum guaranty amount available. The seven sub-paragraphs consider: (1) affiliation based on ownership, including the principal of control of one entity over another; (2) affiliation arising under stock options, convertible securities, and agreements to merge, including the principal of control of one entity over another; (3) affiliation based on management, including the principal of control of one entity over another; (4) affiliation based on identity of interest between close relatives; (5) affiliation based on franchise and license agreements, including the principal of control of one entity over another; (6) determining the concern's size; and (7) exceptions to affiliation.

Participating CA Lenders and the public have requested simplification of the affiliation rules for SBA's financial assistance programs, and recent Congressional actions have streamlined the affiliation rules for certain circumstances. For example,

certain temporary COVID-19 pandemic relief programs enacted by Congress streamlined SBA's financial assistance affiliation requirements to speed relief to small businesses in hard-hit industries. For example, the CARES Act created the Paycheck Protection Program (PPP), which is a temporary 7(a) Loan Program, and for that program, Congress waived affiliation requirements for businesses operating under North American Industry Classification System (NAICS) Code 72 (Accommodations and Food Services), for small businesses operating under a franchise agreement listed on SBA's Franchise Directory, and for small businesses that were financed by a Small Business Investment Company (SBIC).

Drawing on the successful experience of affiliation streamlining under the temporary pandemic relief programs and mindful of CA Lender and public comments requesting affiliation streamlining for the CA Pilot Program, SBA is modifying the regulation at 13 CFR 121.301(f), using the term modify as contemplated under 13 CFR 120.3, for Applicants for CA loans to simplify the program requirements, streamline the application process for CA loans, and facilitate the review of such applications. SBA is specifically removing the principal of control of one entity over another when determining affiliation because the concept of control has proven particularly burdensome for applicants and lenders to understand and implement.

Accordingly, for purposes of the CA Pilot Program, CA Lenders will apply the following principles of affiliation to Applicants for CA loans:

- Affiliation. Any of the circumstances described below establishes affiliation for applicants of the CA Pilot Program:

1. Ownership.

- i. Considering what the applicant or applicant's owners own.

- A. Entities the Applicant owns. An applicant is affiliated with another business entity where the applicant owns more than 50 percent of another business.

B. Entities owned by owners of the applicant. An applicant is affiliated with another business entity where no single individual or entity owns more than 50 percent of the applicant,

1. An owner of 20 percent or more of the applicant owns more than 50 percent of the other business entity, and

2. The applicant operates in the same 3-digit NAICS subsector as the other business entity.

ii. Considering who owns the applicant.

A. An applicant is affiliated with another business entity where the other business entity owns more than 50 percent of the applicant.

B. An applicant is affiliated with another business entity where no single individual or entity owns more than 50 percent of the applicant,

1. The other business entity owns 20 percent or more of the applicant, and

2. The other business entity operates in the same 3-digit NAICS subsector as the applicant.

2. Stock options, convertible securities, and agreements to merge.

i. SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the ownership of the entity. SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised.

ii. Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered “agreements in principle” and are thus not given present effect.

iii. Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable

under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.

iv. SBA will not give present effect to individuals', concerns', or other entities' ability to divest all or part of their ownership interest in order to avoid a finding of affiliation.

3. Determining the concern's size. In determining the concern's size, SBA counts the receipts, employees (§ 121.201), or the alternate size standard (if applicable) of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit.

4. Exceptions to affiliation. For exceptions to affiliation, see 13 CFR 121.103(b). Additional guidance will be provided in the updated CA Participant Guide.

#### 4. General Information

The changes in this document are limited to the CA Pilot Program only. All other SBA guidelines and regulatory modifications related to the CA Pilot Program remain unchanged. The regulatory modifications described in this document are authorized by 13 CFR 120.3, which provides that the SBA Administrator may suspend, modify, or waive rules for a limited period to test new programs or ideas. These modifications apply only to loans made under the CA Pilot Program, which expires September 30, 2024.

SBA has provided more detailed guidance in the form of a CA Participant Guide that is being updated to reflect these changes and will be available on SBA's website at <https://www.sba.gov>. SBA may provide additional guidance, through SBA notices, which may also be published on SBA's website at <https://www.sba.gov/category/lender-navigation/forms-notices-sops/notices>. Questions regarding the CA Pilot Program may be

directed to the Lender Relations Specialist in the local SBA district office. The local SBA district office may be found at <https://www.sba.gov/about-offices-list/2>.

**Authority:** 15 U.S.C. 636(a)(25) and 13 CFR 120.3.

Isabella Casillas Guzman  
*Administrator.*

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